

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Northern Illinois Gas Company d/b/a	:	
Nicor Gas Company (Tariffs filed April 29,	:	
2008)	:	08-0363
	:	
	:	
	:	
Proposed general increase in natural gas	:	
rates.	:	

**STAFF PREHEARING MEMORANDUM
OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION**

NOW COME the Staff witnesses ("Staff") of the Illinois Commerce Commission ("Commission"), through its undersigned attorneys, and files this Pretrial Memorandum.

I. Introduction / Statement of the Case

II. Overall Revenue Requirement and Revenue Deficiency

III. Test Year

IV. Rate Base

A. Overview

B. Uncontested Issues

C. Contested Issues

1. NRRC

2. Cash Working Capital ("CWC")

(Kahle Staff Ex. 1.0 pp. 8-11 and Kahle Staff Ex. 14.0 pp. 5-10)

Staff is proposing to reduce the amount of CWC added to rate base by applying revenue lag days of zero to pass-through taxes in the CWC calculation. Pass-through taxes are not revenue, and therefore cannot have a revenue lag. Ratepayers provide pass-through taxes for the Company to hold and later remit to taxing bodies. If a revenue lag for pass-through taxes is included in CWC and added to rate base, Investors

will earn a return on ratepayer supplied funds. Staff recommends a reduction of CWC, and therefore rate base, of (\$25,055).

2. Gas in Storage

4. Pension Asset

(Hathhorn Staff Ex. 2.0 pp. 3-10 and Sch. 2.01 and Hathhorn Staff Ex. 15.0 pp. 3-8 and Sch. 15.01)

Staff opposes the Company's inclusion of its pension asset in rate base since it was paid for with ratepayer funds. The Commission has twice ruled with Staff on this issue and no facts have changed to merit a reversal. Staff recommends a (\$142,044,000) (Nicor Gas Ex. 26.2) as a rate base deduction. There will be legal argument regarding applying the former Commission decisions on the same facts to this case and possibly regarding the applicability of an appellate decision in the recent Commonwealth Edison Company rate case.

5. Gross Plant

Northern Region Reporting Center

(Maple Staff Ex. 10.0 pp. 3-4, 9-12 and Maple Staff Ex. 23.0 pp. 3-5, 9-12) Staff recommends disallowing this plant addition based on lack of need, lack of cost savings and that it won't be used and useful in the test year. The used and useful standard is found in the PUA at Sections 9-211 and 9-212. Staff recommends reducing gross plant by \$5.9 million and the related impact on accumulated depreciation, accumulated deferred income taxes and depreciation expense.

2008 and 2009 Estimated Plant Additions

(Ostrander Staff Ex. 4.0 pp. 3-4 and Ostrander Staff Ex. 17.0 pp. 3-4)

Staff recommends a finding that 2008 and 2009 estimated plant additions are overstated based on the Company's historical pattern of overestimating its projected plant additions. Budgeted plant additions for 2008 and 2009 are not an accurate indicator of actual plant additions for those years because the Company has overestimated plant additions by 2.87% between 2004 and 2007. In the Company's last rate case, the Commission accepted an adjustment to reduce the Company's forecasted plant additions based on an average of historical under budget variances that was only 0.8%. Staff recommends reducing gross plant by \$8.7 million and the related impact on accumulated depreciation, accumulated deferred income taxes and depreciation expense.

6. Accumulated Reserve for Depreciation and Amortization

7. Incentive Compensation

This issue is now uncontested: Staff recommends disallowance of half the cost of the goal for at-fault hit ratio per 1,000 locates since the Company's historical performance of this goal indicates it has never achieved the level required for a 100% payout of the goal. Staff recommends a (\$7,000) (Nicor Gas Ex. 45.3) rate base deduction. A resulting operating expense deduction, and a payroll taxes deduction are discussed under operating expenses.

8. Other

V. Operating Expenses

A. Overview

B. Uncontested Issues

1. Incentive Compensation

Staff recommended and the Company accepted in rebuttal testimony to disallow the costs of several incentive compensation plans charged from its consolidated pool charges for costs related to shareholder oriented goals. There will be a (\$2,393,000) operating expense deduction, plus payroll taxes.

2. Pension Credit

3. Environmental Expenditures

(Jones Staff Ex. 3.0 p. 20)

The Company accepted Staff's adjustment to disallow costs associated with the clean up of mercury regulators. Staff's adjustment reduces G & A expense by (\$392,000).

(Jones Staff Ex. 16.0 pp. 11-12)

In its rebuttal revenue requirement, the Company included \$564,000 for expenditures related to a new environmental waste disposal program initiated in 2008. \$282,000 was capitalized and \$282,000 was included in O&M expense. Staff does not oppose the adjustment.

4. Invested Capital Taxes

(Hathhorn Staff Ex. 2.0 pp. 19-20, Schedule 2.04 and Hathhorn Staff Ex. 15.0 p. 3, Schedule 15.04)

The Company accepted Staff's methodology to calculate the increase in invested capital taxes based upon the approved operating income in this case rather than included as a part of the gross revenues conversion factor. Therefore, Staff's rebuttal operating expense adjustment of (\$371,000) will have to be updated for the final Commission conclusions in this case.

5. Promotional Expenses

(Jones Staff Ex. 3.0 pp. 9-17)

The Company accepted Staff's adjustments to Charitable Contributions, Office Supplies and Expenses, and Memberships and Dues to disallow costs that are of a promotional nature, which are prohibited by Section 9-225(2) of the PUA. Staff's adjustments reduce G&A expense by (\$568,000).

6. Training/Seminar Expenses

(Jones Staff Ex. 3.0 pp. 17-18)

The projected amounts of training and seminar expenses in the test year appear to be excessive based on historical spending patterns. The Company accepted Staff's adjustment to reduce training and seminar expenses by (\$404,000) to reflect more reasonable amounts.

C. Contested Issues

1. Incentive Compensation Costs and Expenses

(Hathhorn Staff Ex. 2.0 pp. 11-19, Schedule 2.03 and Hathhorn Staff Ex. 15.0 pp. 9-12, Schedule 15.03)

1) Staff recommends disallowance of the Incentive Compensation Units ("ICU") plan cost since it is based solely on achievement of financial goals, and the Company has demonstrated no benefits to ratepayers, as it cannot, since the employees no longer work for the Company. Staff recommends a (\$325,000) operating expense deduction.

2) This issue is now uncontested: Staff recommends disallowance of half the cost of the goal for at-fault hit ratio per 1,000 locates since the Company's historical performance of this goal indicates it has never achieved the level required for a 100% payout of the goal. In addition to the \$15,000 rate base deduction referenced above, Staff recommends a (\$53,000) operating expense deduction, and a (\$29,000) payroll taxes deduction related to items 1 and 2 above. There will be legal argument regarding applying former Commission decisions on Incentive Compensation Expense adjustments to the facts in this case.

2. Uncollectible Accounts Expense

(Hathhorn Staff Ex. 2.0 pp. 10-11, Schedule 2.02 and Hathhorn Staff Ex. 15.0 pp. 8-9, Schedule 15.02)

Staff opposes the Company's level of uncollectibles expense calculated from an assumed 2.25% uncollectibles rate. Staff uses Company 2007-2008 experience to recommend a more appropriate increase to 2.02% from its prior level of 1.4%. Staff recommends a (\$6,981,000) operating expense deduction.

3. Rate Case Expense

(Jones Staff Ex. 3.0 pp. 3-5 and Jones Staff Ex. 16 pp. 2-4)

Staff is proposing to amortize rate case expense over 4 years instead of 3 years, as proposed by the Company. Staff's rationale is that Proposed Riders VBA and EEP are structured as 4-year pilot programs; Nicor Gas has a history of long periods of time between rate proceedings; there is no mechanism for returning an over-recovered amount to ratepayers. Staff's proposed adjustment reduces G & A expense by (\$529,000).

4. Payroll / Headcount

(Hathhorn Staff Ex. 15.0 p. 12)

Staff opposes adopting the Attorney General's payroll expense adjustment.

5. Mains & Services Expenses**6. Customer Records & Collection Expenses****7. Charitable Contributions**

(Jones Staff Ex. 3.0 pp. 6-9 and Jones Staff Ex. 16.0 pp. 4-9)

Staff is proposing to disallow Company contributions to the Aurora Foundation and to the Salvation Army-Chicago.

1) Aurora Foundation - Company contribution specifically funds the Nicor Gas Scholarship Fund, which is administered by the Aurora Foundation. Scholarship benefits are limited to the children of Nicor Gas' employees. The contribution is not for the public welfare or for charitable purposes and should not be recovered from ratepayers. Staff's proposed adjustment reduces G & A expense by (\$100,000).

2) Salvation Army-Chicago – The contribution represents the Company's match of contributions from Nicor Gas customers and employees to the Nicor Gas Sharing Program, which is administered by the Salvation Army-Chicago. The cost should be paid by shareholders. Otherwise, ratepayers are paying twice – once through direct contributions and again through base rates. Staff's proposed adjustment reduces G & A expense by (\$220,000).

8. Depreciation and Amortization Expenses**9. Taxes Other than Income Taxes****10. Income Taxes****11. Interest Synchronization**

VI. Rate of Return

A. Uncontested Issues

(Freetly Staff Ex. 5.0, Schedule 5.1 and Freetly Staff Ex. 18.0C, Schedule 18.1, Co. Ex. 24.1, and CUB Ex. 2.0 p. 14)

The parties agree that the embedded cost of Nicor Gas' long-term debt is 6.80% and the embedded cost of Nicor Gas' non-redeemable preferred stock is 4.77%.

B. Capital Structure (Inclusion of Short-Term Debt)

(Freetly Staff Ex. 18.0C Schedule 18.1)

Staff recommends a capital structure for Nicor Gas comprising \$255,640,082 (18.21%) of short-term debt, \$495,195,694 (35.27%) of long-term debt, \$1,386,144 (0.10%) preferred stock, and \$651,818,845 (46.42%) of common equity.

1. Inclusion of Short-Term Debt

(Freetly Staff Ex. 5.0 pp. 3-6 and Freetly Staff Ex. 18.0C pp. 6-14)

The primary issue with regard to the capital structure is whether or not short-term debt should be included in Nicor Gas' capital structure. Staff maintains that Nicor Gas uses short-term debt to finance a portion of its rate base, and therefore, short-term debt should be included in the Company's capital structure. CUB agrees with Staff's position to include short-term debt in the capital structure (CUB Ex. 2.0, p. 14).

2. Adjustments to Other Capital Components Based on the Calculation of AFUDC Balances

(Freetly Staff Ex. 5.0 pp. 7-8 and Freetly Staff Ex. 18.0C pp. 13-14)

Staff adjusts all of the components of its recommended capital structure to reflect the Commission's methodology for calculating the allowance for funds used during construction (AFUDC), which assumes that short-term debt is the first source of funds for financing construction-work-in-progress (CWIP) and that any CWIP not funded by short-term debt is funded proportionally by the remaining sources of capital.

C. Cost of Short-Term Debt

(Freetly Staff Ex. 18.0C pp. 15-16)

Staff estimates the Company's cost of short-term debt is 2.50%. Staff's estimate is based on the current interest rate on commercial paper and includes the bank commitment fees required for the Company to maintain the bank lines of credit that support its commercial paper program. CUB adopted Staff's cost of short-term debt recommendation (CUB Ex. 2.0, p. 14).

D. Cost of Common Equity**1. ROE Calculation**

(Kight-Garlich Staff Ex. 19.0C pp. 10-12 and Kight-Garlich Staff Ex. 6.0C p. 2, pp. 21-25)

Staff estimates the investor-required rate of return on common equity for Nicor Gas is 9.68%. Staff measured the investor-required rate of return on common equity for Nicor Gas with non-constant DCF and CAPM analyses, which it applied to a sample of utility companies similar in operating risk to Nicor Gas. To reduce issues in this case only, Staff recommended using published beta estimates in the CAPM analysis. The ratio analysis for Nicor Gas and the companies in Staff's sample indicate that Nicor Gas is significantly less risky than Staff's sample. Accordingly, Staff adjusted the investor-required rate of return for its sample downward to derive its estimate of the investor-required rate of return for Nicor Gas.

2. Effect of Proposed Riders

(Kight-Garlich Staff Ex. 6.0C pp. 28-30)

Staff has recommended a 13 basis point reduction to the cost of equity for Riders VBA and UEA (6.5 basis points each).

E. Overall Cost of Capital (Derivative)

(Freetly Staff Ex. 18.0C Schedule 18.1)

Staff recommends a 7.35% rate of return on rate base on Nicor Gas' rate base.

VII. Cost of Service and Allocation Issues**A. Overview****B. Uncontested Issues****C. Contested Issues****1. Main Size Allocation****2. Allocation of Storage Costs to Unbundled Rate Classes****D. Interclass Allocation Issues****VIII. Rate Design****A. Overview****B. Uncontested Issues****1. Rate 6 and Rate 76 Design**

C. Contested Issues**1. Rate 1 Design****2. Rate 1 Design and Conservation****3. Rate 1 design - Alternative Straight Fixed Variable**

(Lazare Staff Ex. 7.0 pp. 34-39 and Lazare Staff Ex. 20.0 pp. 19-23)

The proposal for significant increases in customer charges based on the Single Fixed Variable ("SFV") approach presents a number of problems in that it reduces ratepayers' incentive to conserve gas; raises a consistency issue between how costs are caused and how revenues are collected; conflicts with the Company's beliefs concerning cost causation for distribution costs; creates an inequity for smaller customers who are required to pay the same for plant components as larger customers despite their smaller contribution to these costs; and could make it more difficult for ratepayers in financial distress to control their natural gas costs. The more reasonable alternative is to limit customer charges to recovery of customer costs only.

4. Rate 4 and Rate 74 Design

(Lazare Ex. 7.0 p. 41-42 and Lazare Staff Ex. 20.0 pp. 12-16, 24-25)

The Company's proposed declining block rate present problems because declining block rates would encourage more gas use, leading to higher rates and bills in the long term and the Company has failed to show that a declining block rate is consistent with cost-causation principles. Flat rates provide a more reasonable alternative because they are more consistent with cost and conservation principles.

5. Rate 5 and Rate 75 Design**a. Overview****b. Annual Therm Limitation****6 Rate 7 and Rate 77 Design****7. Other****IX. Tariff Revisions Affecting Transportation Customers****A. Overview****B. Uncontested Issues****1. Individual and Group Administration Charges**

2. **Recording Device Charges**
3. **Group Change Fees**
4. **Transportation Service Credit**
5. **Gas Supply Cost / Demand Gas Cost**

C. Contested Issues

1. Proposed Reductions in Nomination Rights

a. Reduction of Maximum Daily Nominations (“MDN”) in the months of July through October

(Sackett Staff Ex. 11.0R pp. 6-16 and Sackett Staff Ex. 24.0 pp. 6-13)
 Nicor Gas has proposed to reduce the nomination rights during the months of July through October to incent transportation customers to cycle their banks in April. Staff opposes this reduction because it would reduce the flexibility for transportation customers. Staff disputes Nicor Gas’ assertion that transportation customers’ actions raise sales customers’ gas costs.

b. Reduction of Maximum Daily Nominations (“MDN”) in the months of March and April

(Sackett Staff Ex. 11.0R pp. 16-20 and Sackett Staff Ex. 24.0 pp. 6-9, 13-15)
 Nicor Gas has proposed to reduce the nomination rights during the months of March and April to make it more difficult for transportation customers to inject gas into their banks when the Company is attempting to cycle its storage fields. Staff opposes this reduction because it would reduce the flexibility for transportation customers. Staff disputes Nicor Gas’ assertion that transportation customers’ actions raise sales customers’ gas costs.

2. Storage Calculations

a. SBS Entitlement

(Sackett Staff Ex. 24.0 pp. 15-25)

Nicor Gas has proposed to keep the number of days of Storage Banking Service (SBS) entitlement at 28 days. However, since the Company’s peak design day has decreased, this really means a lower share of that deliverability. Staff opposes this approach because Nicor Gas has not demonstrated why its new capacity-like measurement is more appropriate than the capacity that the Commission ordered in the last rate case.

b. Storage Banking Service (“SBS”) Charge

(Sackett Staff Ex. 11.0R pp. 20-24 and Staff Ex. 24.0 pp. 15-22, 25-29)

Nicor Gas has proposed to change Storage Banking Service charge from \$.0029 per therm to \$.0042 per therm. Staff opposes this approach because Nicor Gas has not demonstrated why its new capacity-like measurement is more appropriate than the capacity that the Commission ordered in the last rate case; Staff recommends the charge to be \$.0038 per therm.

c. Storage Withdrawal Factor

i. Storage Withdrawal Constant

(Sackett Staff Ex. 24.0 pp. 15-22)

Nicor Gas has proposed to change Storage Withdrawal Factor constant from 1.7% to 1.8%. Staff opposes this approach because Nicor Gas has not demonstrated why its new capacity-like measurement is more appropriate than the capacity that the Commission ordered in the last rate case.

ii. Timing of the Storage Withdrawal Multiple Calculation

(Sackett Staff Ex. 24.0 pp. 29-31)

Staff opposes IIEC’s proposal to change Storage Withdrawal Multiple from a one-time calculation on November 1 to a maximum amount between October 15 and November 15 because Nicor Gas does not have accurate SBS inventory data on a daily basis between billing periods.

iii. Other

3. Costs Associated with Storage and System Losses

a. Storage Loss Adjustment (“SLA”) Factor

(Sackett Staff Ex. 11.0R pp. 24-26 and Sackett Staff Ex. 24.0 pp. 31-33)

Staff recommends the Storage loss adjustment be recovered from Hub customers as well as sales and transportation customers, through the UFGA.

b. Unaccounted-For Gas Adjustment (“UFGA”)

(Sackett Staff Ex. 11.0R pp. 24-26 and Sackett Staff Ex. 24.0 pp. 33-34)

Staff recommends the storage losses and system losses be recovered from Hub customers as well as transportation customers, through the UFGA.

4. Intra-day Nominations

(Sackett Staff Ex. 24.0 pp. 34-36)

Staff supports a pilot version of this approach because it offers greater flexibility to transportation customers without unduly degrading service for Sales customers or putting reliability at risk.

5. Trading of Stored Gas

(Sackett Staff Ex. 24.0 pp. 36-37)

Staff supports VES' proposal that Nicor Gas allow transportation customers to trade gas in their banks even when their banks are not over filled because it offers greater flexibility to transportation customers without unduly degrading service for Sales customers or putting reliability at risk.

6. Timing of MDCQ

(Sackett Staff Ex. 24.0 pp. 37-38)

VES has proposed that Nicor Gas calculate MDCQ for transportation customers based solely on the most recent heating season. Staff supports a modification of this approach that would still use annual data but shift the calculation so that it can use the data for the most recent heating season. This approach more accurately reflects annual usage for seasonal customers while still using the most up-to-date information.

7. Super-pooling on Critical Days

(Sackett Staff Ex. 24.0 pp. 38-40)

Staff supports CNE's proposal that Nicor Gas calculate the penalties for Critical Days based on the net usage for all of their customers as opposed to the net usage of each group internally because it offers greater flexibility to transportation customers without unduly degrading service for Sales customers or putting reliability at risk.

8. Seasonal Usage Maximum

(Sackett Staff Ex. 24.0 pp. 40-41)

Staff supports VES' proposal that Nicor Gas allow customers with a seasonal load profile and annual usage up to 1.5 million therms to qualify for seasonal service under Rates 5 and 75 because it offers greater flexibility to transportation customers without unduly degrading service for Sales customers or putting reliability at risk.

9. Other**X. Tariff Revisions Affecting Customer Select Customers****A. Overview****B. Uncontested Issues**

1. **Customer Select Balancing Charge (“CSBC”)**
2. **Carrying Cost of Capital for Working Gas**
3. **Customer Select Administrative Fee**
4. **Access to Nicor Gas Assets**

XI. Existing Riders

A. Rider 2 – Franchise Cost Adjustment

(Hathhorn Staff Ex. 2.0 pp. 32-33)

Staff recommended the Company provide workpapers with its annual informational filing. The Company accepted Staff’s recommendation.

B. Rider 5 – Storage Service Cost Recovery

C. Rider 8 – Adjustments for Municipal and State Utility Taxes

(Boggs Staff Ex. 8.0 pp. 6-9 and Boggs Staff Ex. 21.0 pp. 1-4)

Staff has concerns with the Company’s proposal. The Company has not demonstrated how the change will be implemented.

XII. New Riders

A. Overview

(Lazare Staff Ex. 7.0 pp. 3-4, 7 and Lazare Staff Ex. 20.0 pp. 2-4)

The benefits of these proposed riders do not justify the associated costs because the rider concept conflicts with the traditional approach by singling out one cost to be recovered on a stand-alone basis and by allowing the utility to change rates between rate cases. Staff is also concerned that rider recovery would come first and any finding of prudence would be made in a reconciliation proceeding to follow. This is contrary to traditional ratemaking where prudence must be established before costs can be recovered from ratepayers.

B. Rider 26 – Uncollective Expense Adjustment

(Lazare Staff Ex. 7.0 pp. 5-6, 8, 9-15 and Lazare Staff Ex. 20.0 pp. 4-6, 7-9)

Rider UEA should be rejected because Rider UEA would shift risk associated with higher gas prices away from the Company onto ratepayers. Uncollectibles are not volatile in comparison to other system costs and therefore do not warrant rider recovery. The evidence does not show that the Company increased its efforts to address uncollectibles as the problem has grown. The Company would receive inappropriate incentives concerning the control of uncollectibles costs under its proposed rider.

(Hathhorn Staff Ex. 2.0 pp. 26-29)

Staff recommends several changes to the Rider if the Commission rejects Staff’s primary position to reject the Rider. The Company accepted all of Staff’s recommendations.

C. Rider 27 – Company Use Adjustment

(Brightwell Staff Ex. 13.0 p. 22-23, 26-27 and Brightwell Staff Ex. 25.0 p. 3-4)

Staff recommends that the Commission reject Rider CUA. Staff's concern with Rider CUA are (i) whether the volatility of natural gas prices causes Company use gas costs to rise to a level that justifies recovery through a Rider; (ii) whether lost and unaccounted for gas storage losses are being measured properly and whether any incorrect measurement leads to improper financial accounting; and (iii) whether proposed Rider CUA adversely affects the Company's incentive to seek new business practices or incorporate new equipment that reduce the usage of natural gas and reduce the Company's exposure to price volatility.

If Rider CUA is approved, Staff proposes removing the reference to ACUT from the definitions of RCCUT and RCTSCUT and disallowing recovery of Company use gas costs associated with account 823 from Rider CUA.

(Hathhorn Staff Ex. 2.0 pp. 29-32)

Staff recommended several changes to the Rider if the Commission rejects Staff's primary position to reject the Rider. The Company accepted all of Staff's recommendations.

D. Rider 28 – Volume Balancing Adjustment

(Jones Staff Ex. 3.0 pp. 27-31 and Jones Staff Ex. 16.0 pp. 12-14)

Staff describes an alternative form of Rider VBA that the Commission may wish to consider should it decide to approve another Rider VBA pilot program. This alternative is not tied to rate case margin per customer; it looks only at total distribution revenues to cover fixed costs as approved in a rate proceeding. Staff is not making a recommendation regarding which form of Rider VBA is appropriate, and there is no proposed adjustment to the revenue requirement.

E. Rider 29 – Energy Efficiency Plan

(Brightwell Staff Ex. 13.0 pp. 6-11, 15-16, 18 and Brightwell Staff Ex. 25.0 pp. 9-11, 14-15)

Staff recommends that the Commission reject Rider EEP. Staff's concern's with the proposed Rider EEP is that there is no clear evidence that this program is cost effective. The proposed management structure makes it difficult to hold the Company or the Advisory Board accountable to ratepayers for any improper expenditure. Placing clear accountability on Nicor Gas, while maintaining the program as a pilot, may give the Company the incentive to subvert the intended autonomy of the proposed management structure by threatening to discontinue the program upon completion of the pilot. The Conservation Stabilization Adjustment ("CSA") is problematic because those measuring the lost therms have an incentive to overstate reductions, and the lost therms from some proposed programs are very difficult to measure and ex-post evaluations of overall program effectiveness are not incorporated into the reconciliation of the CSA. If Rider EEP is approved, Staff proposes changing the management structure so that Nicor Gas is clearly in charge of the decisions being made but allow for open meetings where interested stakeholders are still capable of lending any experience and expertise to the process and removing the CSA clause from Rider EEP.

F. Rider 30 – Qualifying Infrastructure Plant

(Lazare Staff Ex. 7.0 pp. 17-22 and Lazare Staff Ex. 20.0 pp. 9-10)

Rider QIP should be rejected because the Company is seeking extraordinary recovery through the rider of costs to provide ordinary gas service; the Company has failed to identify ratepayer benefits from rider treatment of these costs; the associated costs are not volatile; the Company fails to identify how an acceleration of the mains and services replacement program would benefit ratepayers; and the relatively small amount of dollars at stake each year calls into question whether the establishment of an oversight process for Rider QIP can be cost-justified.

(Anderson Staff Ex. 9.0 pp. 4-8 and Anderson Staff Ex. 22.0 pp. 2-6)

Staff believes Nicor Gas has failed to demonstrate the need to drastically increase its replacement of cast iron main and copper services.

(Hathhorn Staff Ex. 2.0 pp. 20-26)

Staff recommended several changes to the Rider if the Commission rejects Staff's primary position to reject the Rider. The Company accepted all of Staff witness Hathhorn's recommendations.

XIII. Terms and Conditions**A. Proposed Changes****B. Uncontested Issues****C. Contested Issues****XIV. Revenues****A. Total Billing Units / Rate 4 and Rate 74 Billing Units****B. Nicor Energy Services Billing Adjustment**

(Hathhorn Staff Ex. 15.0 pp. 12-14, Schedule 15.05)

Staff recommends the Company's billings to Nicor Energy Services be charged at the prevailing rate, rather than fully distributed costs, since it performs essentially the same services to Nicor Solutions and charges Nicor Solutions a prevailing rate. The Operating Agreement requires the affiliate to charge a prevailing rate if that rate is higher than fully distributed costs. Staff recommends a (\$588,000) operating expense deduction.

XV. Gross Revenue Conversion Factor**XVI. Other Issues**

A. Accounting for Storage Gas Losses

(Hathhorn Staff Ex. 2.0 pp. 33-35 and Hathhorn Staff Ex. 15.0 pp. 14-18)

Staff recommends the Company record its physical gas losses in Account 823 and performance variations in Account 352.3.

(Anderson Staff Exhibit 9.0 pp. 9-30 and Anderson Staff Exhibit 22.0 pp. 7-19)

Staff recommends Nicor track all storage losses into two components: 1) physical losses and 2) performance variations and account for them appropriately. Nicor Gas failed to support use of 2% loss factor associated with company owned storage losses. On a going forward basis, the Company must develop written procedures to track storage losses into their two components and provide sufficient documentation to support these values in next rate case.

B. Reporting of Affiliate Transactions

(Hathhorn Staff Ex. 2.0 pp. 35-36 and Hathhorn Staff Ex. 15.0 p. 18)

The Company accepted Staff's recommendation for annual reporting of its affiliated interest transactions as a supplemental page to its Form 21.

C. Operating Agreement

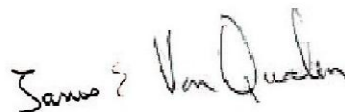
(Hathhorn Staff Ex. 15.0 pp. 18-22)

The Company has stipulated that it does not oppose Staff's recommendation to investigate and revise its Operating Agreement for affiliated interest transactions.

XVII. Conclusion

Wherefore, Staff respectfully prays that this Pretrial Memorandum of the Staff of the Illinois Commerce Commission be considered in this matter.

Respectfully submitted,



November 7, 2008

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